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Darcy L. Endo-Omoto
Vice President
Government & Community Affairs

March 30, 2009

The Honorable Chairman and Members of
the Hawaii Public Utilities Commission
Kekuanaoa Building, 1st Floor
465 South King Street
Honolulu, Hawaii 96813

Dear Commissioners:

Subject: Docket No. 2008-0274 – Decoupling Proceeding
HECO Companies' Initial Statement of Position

In accordance with the *Order Approving, with Modifications, Stipulated Procedural Order Filed on December 26, 2008*, enclosed for filing is the HECO Companies'[1] initial statement of position on Haiku Design and Analysis' proposal submitted on February 19, 2009 in its responses to the questions in Appendix 2 of the Commission's decoupling scoping paper, *"Decoupling" Utility Profits from Sales: Design Issues and Options for the Hawaii Public Utilities Commission*, prepared by the National Regulatory Research Institute ("NRRI").

The HECO Companies are filing separately a Joint Proposal on Decoupling and Statement of Position with the Consumer Advocate.

Sincerely,

Enclosure

cc: Division of Consumer Advocacy
Hawaii Renewable Energy Alliance
Haiku Design and Analysis
Hawaii Holdings, LLC, dba First Wind Hawaii
Department of Business, Economic Development, and Tourism
Hawaii Solar Energy Association
Blue Planet Foundation

[1] The "HECO Companies" are Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc. and Maui Electric Company, Ltd.

HECO Initial Statement of Position on Haiku Design and Analysis' Decoupling Proposal

In its *Responses to the National Regulatory Research Institute Paper Appendix 2 Questions* ("NRRI Response"), Haiku Design Analysis ("HDA") proposed a "fixed charge per customer" earnings decoupling mechanism. In its NRRI Response, HDA contends that:

- Its proposal is different than the revenue per customer freeze described in the HECO proposal (dated January 30, 2009) (p. 7);
- HECO Schedules PT, PP, and PS are already essentially decoupled by way of marginal revenues being almost equal to marginal energy delivery costs (p. 8);
- It is not confident that the HECO proposal would accurately and effectively decouple earnings from sales fluctuations (p. 13).

HECO maintains that:

- HDA's proposal is effectively the same as a revenue per customer freeze;
- HECO Schedules PT, PP, and PS are not already decoupled;
- The Joint Proposal does accurately and effectively decouple earnings from sales fluctuations within the ability of the Commission approved rate design.

HDA's Decoupling Proposal is a Revenue Per Customer Freeze

Pacific Economics Group ("PEG") defines a revenue per customer ("RPC") freeze approach to decoupling as an approach that "effectively freezes the revenue requirement per customer", such that it escalates the revenue require only for customer growth.[1] The HDA proposal is essentially a RPC freeze approach.

In its NRRI Response, HDA proposes an example mechanism "patterned after and . . . essentially identical to the mechanism designed by HDA for Rocky Mountain Institute ("RMI") and proposed to the Commission in the Energy Efficiency Docket No. 05-0069." (page 4). In Attachment 2 of the NRRI Response HDA also refers to the RMI Final Statement of Position ("FSOP"), Exhibit B of that docket.

On page 6 of Exhibit B, the essence of RMI's decoupling proposal is described: "The Non-Fuel Energy Charge would be adjusted periodically (monthly, quarterly or annually) so that net non-fuel revenues grow in proportion with customer growth between rate cases[.]" As described, this is the same as PEG's definition of a RPC freeze approach to decoupling.

It is possible that the reason HDA maintains that its proposed mechanism is different from a RPC freeze is because the index of the number of customers would not be the same as the number of accounts. However, regardless of the definition of customer, the essential operation of the HDA proposed mechanism is to only grow revenues in proportion to customer growth.

The October 2008 Energy Agreement Among the State of Hawaii, Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs, and Hawaiian Electric Companies ("Energy Agreement"), provides that the revenue adjustment mechanism shall be based on cost tracking indices such as those used by the California regulators for their larger utilities or its equivalent and not based on customer

[1] *Revenue Decoupling for Hawaiian Electric Companies*, January 30, 2009, Docket No. 2008-0274, Attachment 1 (Revised 2/03/09), page 8.

count. As HDA's proposed mechanism is based on customer count, it would not comport with the Energy Agreement.

Schedules PT, PP, and PS are Not Already Decoupled

HDA contends that Schedules PT, PP, and PS are already essentially decoupled because their marginal revenues by rate schedule are almost equal to marginal energy delivery costs by rate schedule. HDA points to Attachment 1 of its NRRI Response. However, HECO maintains that the information the HDA reasonably relied upon to build Attachment 1 (HECO proposed rate schedule rates, HECO-RWP-2214, p. 2, Docket No. 04-0113, HECO's 2005 Test Year Rate Case, for marginal energy unit costs) is not appropriate for the purpose used.

For HECO Schedules PT, PP, and PS, the HDA analysis uses the lowest tier of the energy rate pricing as the assumed marginal revenue per kWh. However, that rate is the marginal revenue only where the ratio of billed kWh to billed kW exceeds 400. In fact, not all of the HECO Schedule PT, PP, and PS customers have ratios of billed kWh to billed kW in excess of 400. HECO's marginal revenue from Schedules PT, PP, and PS is dependent on the customer or customers that generate the marginal revenue, and in fact, it is difficult to generalize what the marginal revenue or the marginal revenue rate might be for those rate schedules. However, it would be reasonable to say that the marginal revenues are likely higher than what is represented by the lowest tier of energy rate pricing.

The marginal energy unit costs in HECO-RWP-2214, p. 2, may not accurately represent marginal unit costs because first, those costs were developed using fuel prices higher than the fuel prices used as the cost basis for base rates in the 2005 HECO test year rate case. Therefore, had marginal costs been calculated using the fuel prices used as the cost basis for base rates, they would likely have been lower than shown in HECO-RWP-2214, p. 2. Second, the marginal costs shown in HECO-RWP-2214, p. 2 were developed based on a 1 mWh change in sales, which may not accurately represent the marginal energy costs for a larger change in sales. As a result, the marginal energy costs cannot be compared against the test year rate design, which is the basis of HDA's Attachment 1. It cannot be concluded that Schedule PT, PP, and PS marginal revenues are almost equal to marginal energy delivery costs by rate schedule.

HECO maintains that actual marginal revenues and marginal costs for changes in Schedules PT, PP, and PS sales are not known. However, sales from all rate schedules should be subject to the decoupling mechanism as identified in the Joint Proposal, in order that earnings be effectively decoupled from sales.

<u>The Joint Proposal Accurately and Effectively Decouple Earnings From Sales Fluctuations</u>

Based on comments made at the February 27 Technical Meeting and discussions with HDA held subsequent to the Technical Meeting, HECO understands that HDA's concern stems from its belief that marginal costs (primarily marginal fuel and purchased energy costs) are greater than average costs when sales are decreasing. The marginal fuel and purchased energy costs are recovered by the Companies through their Energy Cost Adjustment Clause ("ECAC"). Therefore, according to HDA, if the proposed sales decoupling mechanism allows the Companies to recover the difference between

Commission-approved revenue requirements and actual billed revenues, and actual billed revenues are based on average costs rather than higher marginal costs, then the Companies would over-recover the proper amount of revenues.

HECO maintains that the Joint Proposal appropriately and accurately recovers revenue through the proposed sales decoupling proposal. The Companies agree that marginal costs may differ from average costs when sales fluctuate and agree further that nearly all of the marginal costs are fuel and purchased energy costs. However, the sales decoupling mechanism included in the Joint Proposal removes all fuel and purchased energy costs that are recovered through base rates and through the ECAC from both the Commission-approved revenue requirements and from actual billed revenues. Furthermore, the quarterly ECAC reconciliations, filed in the Companies' February, May, August, and November Energy Cost Adjustment Factor ("ECAF") filings adjust ECAC revenues for any changes in fuel and purchased energy expenses due to sales fluctuations, subject to the fixed heat rate incentive (efficiency factor). Therefore, by removing the revenue that recovers fuel and purchased energy expenses from both Commission-approved revenues and actual billed revenues, the effect of sales fluctuations on marginal costs are appropriately and accurately accounted for.